listings, inside wire, BDS/I AN, customer premises equipment, and information services.[141]

B. Resale Applies Only To Services Sold "At Retail." (NPRM - II.B.3.)

The resale duty is likewise limited to telecommunications services offered "at retail to subscribers who are not telecommunications carriers."[142] Although some may wish to ignore the phrase "at retail,"[143] the language exists and must be given appropriate meaning when interpreting Section 251(c)(4). The phrase "at retail" is, however, undefined by the Act or the Communications Act prior to the Act, the Conference Report provides no greater insight into its meaning, and the phrase does not appear within the Commission's rules. Under these circumstances, the phrase should be accorded its normal usage. As defined in Webster's Third New International Dictionary, "retail" essentially means "to sell in small quantities directly to the ultimate consumer." By way

---

[141] Further, there are other categories of services for which reasonable resale restrictions should be honored. Among those categories are services offered as part of a trial. By definition, such trials are generally conducted to determine whether to offer a new service "at retail" and by their nature are limited in time and scope. At such time that the telecommunications service offered under a trial is offered at retail to the public (if it ever is), then the duty to permit resale becomes applicable.

[142] 47 U.S.C. Section 251(c)(4)(A).

[143] In comments before the Texas PUC, AT&T attempts to expand the list of services available for resale under the Act. It recommends that avoided costs be calculated for the following service categories: local, toll, switched access, private line/special access and other (billing and collection and directory assistance). AT&T Communications of the Southwest, Inc.'s Responses to Additional Questions, Project No. 15344, April 26, 1996, p. 10.

of contrast, the term "wholesale" means "in quantity for resale; performed on a large scale." Consistent with those definitions and normal usage, telecommunications services provided "at retail" must be those services which ILECs market to the ultimate consumer. Services sold in large quantities or bulk, especially those sold as a vertical input to another service, e.g., access services, cannot be said to be offered "at retail" regardless whether there are any tariffed purchaser restrictions on the service.[144]

C. The Duty To Permit Resale Does Not Void Service Definitions Or Use Restrictions. (NPRM - II.B.3.)

The duty to resell includes a duty "not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, telecommunications service."[145] The Commission should recognize the distinction between the definition of a service and its related use restrictions, and resale restrictions prohibited by the Act. The former refers to the very definition of a telecommunications service, which may include limitations on the offering itself, as well as terms and conditions applicable to the telecommunications service.

For example, some telecommunications services are defined with inherent limitations (a CENTREX® service may be offered only within contiguous properties). Similarly, SWBT continually is confronted with situations where local service intended for use by

---

[144] Public safety services (e.g., E911) cannot accurately be characterized as services sold "at retail."

[145] 47 U.S.C. Section 251(c)(4)(B).

the end user is instead used to aggregate traffic of others for interexchange or access purposes, in violation of SWBT's tariffs.[146] To the extent that a reseller seeks to ignore the inherent definition of a telecommunications service, it wants to resell a service that literally does not exist and that the incumbent carrier does not provide, at retail or otherwise.

Generally applicable definitional limitations and use restrictions (including generally applicable limitations which, for example, prohibit unlawful or obscene uses) are not resale restrictions as contemplated by the Act and therefore remain undisturbed. The Act did not displace an ILEC's ability to enforce its tariffs against its own end users or against resellers and their end users.

D. The Commission Should Not Prescribe Rules Regarding The Resale Of Intrastate Services. (NPRM - II.B.3.)

The Commission should not attempt to dictate to the states the ultimate resolution of the issues that arise under Section 251(c)(6) with respect to intrastate services. The Act does not run roughshod over the interstate/intrastate jurisdictional split created by 47 U.S.C. Section 152(b), which expressly disclaims giving the Commission jurisdiction over the "charges, classifications, practices, services, facilities, or regulations for or in

---

[146] See Southwestern Bell Telephone Co. v. Metro-Line Telecom, Inc., 1996 Tex. App LEXIS 426 (Tx. Appl. 14th) and Southwestern Bell Telephone Co. v. Hillsboro Answering Service, Case Nos. TC-90-65, 1990 Mo. PSC LEXIS 32 (1990), two cases where local services were purchased and "resold" to provide interexchange service in violation of tariffs and state commission access structure orders.

connection with intrastate communications service."[147] Congress is apparently relying primarily upon state commissions with respect to determining what constitutes "unreasonable or discriminatory conditions or limitations" on resale directly and through their role in arbitrating differences between ILECs and resellers and approving resale agreements.[148] The Commission should be careful not to expand beyond the jurisdictional boundaries intended for federal regulation by the Act.

E. There Are Several Legitimate Resale Restrictions. (NPRM - II.B.3.)

The Act prohibits the imposition of unreasonable or discriminatory resale restrictions -- the restrictions that affect the ability of the reseller to offer that particular service to its subscribers. The Commission correctly notes that permitting the resale of cheaper residential local service to business customers is one such reasonable restriction (which is usually the result of state commission rate design decisions).[149] Similarly, the Commission correctly recognizes that a resale restriction is appropriate for local residential service provided under the Lifeline program, given the manner in which

---

[147] Louisiana PSC v. FCC, 476 U.S. 355 (1986).

[148] 47 U.S.C. Section 251(c)(4)(B).

[149] 47 U.S.C. Section 251(e)(4)(B).

ILECs are required to fund that program.[150] The Commission should also acknowledge that certain other restrictions are likewise appropriate.

The Act was intended to create incentives for competition, not to eliminate them. One way to compete for customers is to make a telecommunications service more attractive than the competitors' by offering promotions (both price and non-price) that entice customers. A tremendous disincentive would be created for ILECs if every time they offered a promotion they were required to allow resellers to buy and resell the same promotion at a discounted price. If ILECs chose not to offer such promotions, consumers would be the clear losers, a result neither contemplated nor intended by the Act. Rather, through the process of negotiations, volume and term commitments, though not required, can be used to give competitors the opportunity to compete flexibly and effectively. The reseller, like the wholesale LEC, can create its own packages and pricing. In this manner consumers get more choices of services and packages and not merely a choice of who sends the bill.

Likewise, there should be a recognition that ILEC packages of services designed to achieve increased product penetration or social policy goals are not subject to the resale duty. Packages of separate and distinct telecommunications services, which by

---

[150] Of course, resellers can develop their own Lifeline assistance programs. To provide Lifeline services, resellers should be required to purchase local exchange service at resale rates and, like ILECs, fund the discounted service with the revenue of other services until such time as the FCC and state commissions have made that support explicit as called for in 47 U.S.C. Section 254(b)(5).

themselves are available for resale, do not constitute a single telecommunications service. Further, requiring resale of current LEC retail packages would effectively give competitors all the benefits of the LEC's up-front marketing efforts for free.

Finally, the Commission seeks comment on whether an incumbent "LEC can avoid making a service available at wholesale rate by withdrawing the service from its retail offerings."[151] The Act did not shift to a LEC's competitors the ability to make management decisions with respect to the services that the LEC wishes to offer or discontinue offering; and the Act does not enhance or otherwise alter the applicable standards for withdrawal of any services, particularly for non-essential services. The Act only requires those telecommunications services sold at retail to be resold. However, to the extent that a LEC withdraws a service and "grandfathers" its own subscribers, the LEC should concomitantly be willing to grandfather any reseller's subscribers subject to the same conditions.[152] Of course, in and of themselves, grandfathered services are not subject to the duty to permit resale in that they fall outside the definition of "telecommunications service" because they are not offered to the "public" but rather to a distinct, limited, and shrinking number of particular subscribers.

---

[151] NPRM, para. 175.

[152] Grandfathered services are usually limited to the same customer-of-record at the same address, and may be limited to a maximum length of time. To the extent that either of those parameters change, that particular grandfathered service expires. Again, the exact conditions placed upon a grandfathered service are largely within the discretion of the incumbent LEC, since state regulatory approval is routinely granted.

F. Resale Costing Issues Raised In The NPRM Beyond The Plain Language Of The Act Are Beyond Congress's Intent And Are Inappropriate. (NPRM - II.B.3.)

The NPRM seeks comment on numerous procedures for determining "avoided costs" under the resale pricing provisions of the Act.[153] For example, the Commission asks whether avoided costs should include a share of general overhead,[154] whether it should establish a "uniform set of presumptions" to be imposed upon the states,[155] and whether it should establish rules that "allocate avoided costs across services."[156]

The Act makes clear that

> a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.[157]

Thus, at least with respect to all intrastate services, it is the state commissions, that Congress intends to answer the types of questions raised in the NPRM (and even then, only if carrier negotiations fail and state arbitration is necessary). Further, the Act specifically identifies the types of costs intended to be included within the category of

---

[153] NPRM, paras. 179-183.

[154] Id., para. 180.

[155] Id., para. 181.

[156] Id., para. 182.

[157] 47 U.S.C. Section 252(d)(3) (emphasis added).

LEC "avoided costs." The Commission should not attempt to go beyond its jurisdiction or the plain language of the Act in terms of the avoided costs resale issue.[158]

Avoided costs to be deducted from retail prices in computing wholesale prices of resold services should be defined as:

(1) the direct costs of retailing the given service which cease to be incurred due to the wholesaling of that service to a reseller in lieu of retailing the service directly to end-users

minus

(2) the direct incremental costs of wholesaling the given service to resellers.

The Commission should closely adhere to the language of the Act. It is beyond debate that this is an area reserved to the states by the Act, and that costs not avoided by resale are not to be deducted from retail prices in arriving at wholesale rates.

---

[158] Although elsewhere in the NPRM the Commission proposes to prohibit states from using the Efficient Component-Pricing Rule (ECPR) (NPRM, para. 148), it should be noted that the Act tacitly applies the ECPR in its provisions for setting wholesale prices of resold services. Section 252(d)(3) of the Act states: "For the purposes of Section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier." 47 U.S.C. Section 251(d)(3) (emphasis added). This is a direct application of the ECPR. The fact that this "avoided cost" rule is equivalent to the ECPR often goes unrecognized; however, it is mathematically equivalent (see Appendix A). Furthermore, the NPRM proposal that states be precluded from using the ECPR methodology for any purpose is beyond the FCC's jurisdiction. 47 U.S.C. Section 152(b), Louisiana PSC v. FCC, 476 U.S. 355 (1986).

G. Resale Should Be Required Only Under Existing Retail Terms And Conditions. (NPRM - II.B.3.)

The Commission should clarify that ILEC services required to be resold under the Act are subject to the same terms and conditions under which they are currently sold at retail. Otherwise, a reseller could buy a service wholesale from an ILEC, and modify essential terms and conditions such that the service it was then "reselling" would no longer be the same service offered by the ILEC at retail.

For example, ILEC tariffs for CENTREX® service typically contain a contiguous property requirement because the service was designed to replicate a PBX utilized by a single entity on a single property. It was not intended to be used as a substitute for local exchange calling among unrelated entities/parties, nor for private line type services between distant properties. Therefore, if an ILEC resells CENTREX® service it should be with the understanding that the reseller likewise will resell it only pursuant to the contiguous property requirement, to a single end user, and in accordance with any other existing terms and conditions. To allow otherwise would permit resellers to change the fundamental character of the ILEC's retail service. That would go well beyond what was intended by the resale provisions of the Act, and would create the potential for resellers to abuse the resale process.

VI. UNBUNDLING RULES MUST AVOID ARBITRAGE AND INEFFICIENCIES, INCORPORATE APPROPRIATE COSTING, AND BE MARKET-DRIVEN

A. Unbundling Must Not Threaten The Current Access Structure. (NPRM - II.B.2.)

The NPRM acknowledges the position of some parties that 47 U.S.C. Section 251(c)(3) should be read to allow IXCs, in effect, to obtain network elements in order to avoid entirely the FCC's Part 69 access charges.[159] The Commission correctly noted that this position is wholly unwarranted. It would result in arbitrage that would destroy the current industry access structure. The express language of Section 251 of the Act demonstrates Congressional intent that this section initially provide for interconnection between competing local exchange carriers only. A careful reading of Section 251 also makes it abundantly clear that it does not preempt the existing equal access and access charge regime.

Section 251(g) of the Act provides proof of Congressional intent that the access and interconnection obligations contained in Section 251(c) do not replace the existing exchange access requirements in place on the date of enactment. Section 251(g) provides that on and after enactment,

> each local exchange carrier, to the extent that it provides wireline services, shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory

---

[159] NPRM, para. 164.

> interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy of the commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the commission after such date of enactment.[160]

The BOCs' exchange access obligation was derived from the Modification of Final Judgment (MFJ)[161] preceding the date of enactment. The equal access and exchange access obligations can be found in Section II and Appendix B of the MFJ. The GTE equal access obligation was derived from its own consent decree.[162]

On the date of enactment, the entire local exchange carrier industry was providing equal access and exchange services for such access pursuant to consent decrees, or pursuant to regulation, order, or policy of the Commission. Congress expressly provided that such exchange access and interconnection requirements would continue and "be enforceable in the same manner as regulations of the Commission" until superseded by the Commission.[163]

---

[160] 47 U.S.C. Section 251(g) (emphasis added).

[161] United States v. American Telephone & Telegraph Co., et al., 552 F. Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 103 S. Ct. 1240 (1983).

[162] United States v. GTE Corp., §§ V(A) and (B), No. 83-1298 (D.D.C. December 12, 1984).

[163] 47 U.S.C. Section 251(g).

Despite the Commission's authority under Section 251(g) to supersede existing exchange access obligations and access charge arrangements, Section 251(d)(3) still preserves state authority over the terms and conditions of intrastate access and interconnection arrangements. Section 251(d)(3) provides that in prescribing and enforcing regulations to implement this section, "the Commission shall not preclude the enforcement of any regulation, order, or policy of a state commission that -- (A) establishes access and interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part."[164]

The legislative history also clearly indicates that Congress intended that initially Section 251 would only apply to interconnection between competing providers of local exchange services. The Conference Report states that "[t]he conference agreement adopts a new model of interconnection that incorporates provisions from both the Senate bill and House amendment in a new Section 251 of the Communications Act."[165] Thus, in attempting to interpret the meaning to be given Section 251, it is instructive to look at the

---

[164] 47 U.S.C. Section 251(d)(3) (emphasis added). In addition, in 47 U.S.C. Section 261(c), Congress generally provided that "[n]othing in this part [Part II of Title II] precludes a State from imposing requirements on a telecommunications carrier for intrastate services that are necessary to further competition in the provision of telephone exchange service or exchange access, as long as the State's requirements are not inconsistent with this part of the commission's regulations to implement this part" (emphasis added).

[165] Conference Report, 121.

language of the Senate bill. S.652, and the House amendment, H.R.1555, which passed both houses of Congress respectively, as well as the Conference Report itself.

Section 251(a)(1) of S 652 imposed a duty on local exchange carriers, determined to have market power, to negotiate in good faith with other telecommunications carriers that requested interconnection "for the purpose of permitting the telecommunications carrier to provide telephone exchange or exchange access service . . ." (emphasis added). The Conference Report explained that "[t]he obligations and procedures prescribed in this section do not apply to interconnection arrangements between local exchange carriers and telecommunications carriers under section 201 of the Communications Act for the purpose of providing interexchange service, and nothing in this section is intended to affect the Commission's access charge rules."[166]

Section 251(k) of S. 652 provided further that "[n]othing in this section shall affect the Commission's interexchange-to-local exchange access charge rules for local exchange carriers or interexchange carriers in effect on the date of the Telecommunications Act of 1995." The Conference Report explained:

> New subsection 251(k) provides that nothing in section 251 is intended to change or modify the Commission's rules at 47 C.F.R. 69 et seq. regarding the charges that an interexchange carrier pays to local exchange carriers for access to the local exchange carriers' network. The Senate also does not intend that section 251 should affect regulations implemented under section 201 with

---

[166] Id. at 117 (emphasis added).

respect to interconnection between interexchange carriers and local exchange carriers.[167]

Section 242(a)(1) of H.R. 1555 provided that "(t)he duty under section 201(a) [of the Communications Act] of a local exchange carrier includes . . . (t)he duty to provide, in accordance with subsection (b), equal access to and interconnection with the facilities of the carrier's networks to any other carrier or person offering (or seeking to offer) telecommunications services or information services . . . ." The Conference Report explained that "Section 241(a)(1) sets out the specific requirements of openness and accessibility that apply to LECs as competitors enter the local market and seek access to, and interconnection with, the incumbent's network facilities."[168]

In addition, Section 242(b)(1) of H.R. 1555 provided that "(a) local exchange carrier shall provide access to and interconnection with the facilities of the carrier's network at any technically feasible point within the carrier's network on just and reasonable terms and conditions, to any other carrier or person offering (or seeking to offer) telecommunications services or information services requesting such access." The Conference Report explained that "Section 241(b)(1) describes the specific terms and

---

[167] Id. at 119 (emphasis added).

[168] Id. at 120 (emphasis added).

conditions for interconnection, compensation, and equal access, which are integral to a competing provider seeking to offer local telephone services over its own facilities."[169]

Thus it is clear that, on the date of enactment, Congress intended that Sections 251(a)-(c) govern the access and interconnection arrangements between competing providers of local exchange services, not between LECs and IXCs.

B. Existing Standards Should Dictate Network Elements To Be Unbundled. (NPRM - II.B.2.)

In its NPRM the Commission poses many questions regarding possible standards to govern which network elements should be required to be made available generally on an unbundled basis.[170] SBC's response to these questions is simple and straightforward: existing industry standards tell us precisely what network elements technically can be unbundled at this time, and which ones cannot be. Legitimate network elements are those which the industry has already recognized as such by producing technical standards by which to provision them on an unbundled basis. Before going into detail in that area, however, some fundamental clarification is essential.

---

[169] Id. at 120 (emphasis added).

[170] NPRM, paras. 77-82.

1. The Distinction Between Unbundling And Resale Obligations Is Critical. (NPRM - II.B.2. & II.B.3.)

The Act only requires that "network elements" be unbundled, not services. The Act's definition of network elements makes clear that existing LEC services were not to be included:

> (49) Network Element -- The term "network element" means a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment. . . .[171]

Thus, a network element is a "piece" of a network which, when combined with other pieces of a network, can be used to provide services. Services, on the other hand, are what providers sell to consumers. Throughout the Act the LECs' resale obligations are referred to only within the context of current LEC retail telecommunications services.[172] Thus, network elements are to be unbundled -- not resold, and telecommunications services are to be resold -- not unbundled. The NPRM confuses these two concepts.

For example, SBC disagrees with the Commission's tentative conclusion that incumbent LECs should be required to "unbundle" operator call completion services as a network element pursuant to section 251(c) of the Act.[173] This is a good example of the need to draw a distinction between the facility or equipment used in the provision of a

---

[171] 47 U.S.C. Section 153(29) (emphasis added).

[172] 47 U.S.C. Sections 251(b)(1), 251(c)(4) and 252(d)(3).

[173] NPRM, para. 116.

telecommunications service and the service itself. LECs can meet their statutory obligation to provide non-discriminatory access to operator call completion services under section 271(c) without unbundling these services as a network element. They are not subject to the network element unbundling requirement, and neither are any other services offered by LECs today.

2. An Incumbent LEC Cannot Unbundle What It Does Not Have And Is Not Required To Construct Facilities To Provide Unbundled Elements. (NPRM - II.B.2.)

In addressing unbundling, there must be recognition of a fundamental point -- no ILEC has an infinite number of network elements. Subdividing a network into elements does not expand the capacity of the network, nor increase the number of those elements. The literal language of Section 251(c)(3) presumes that there exists a network element to be unbundled ("nondiscriminatory access to network elements on an unbundled basis at any technically feasible point"). In the vernacular of the statute, there exists no technically feasible point at which to unbundle an element that does not exist.

An example would be where a carrier requests an unbundled loop to a specific customer's house but all loops to that house are already being used either by the ILEC or other carriers that have previously sought and obtained the other existing loop(s) on an unbundled basis. Under that scenario, the ILEC would have to decline the request due to a lack of capacity. The second carrier wanting access to an unbundled loop at that FDI could not be accommodated. There are obviously many other possible examples (e.g.,

switch capacity, interoffice trunks) where a requesting carrier may ask for what an ILEC does not possess.

In these situations, the Act does not impose a duty upon an ILEC to make any network element available simply because another carrier has asked for it regardless of the investment or expense to the ILEC. Inasmuch as network elements are, by definition, neither "telecommunications services"[174] nor common carriage services,[175] an ILEC does not act as a common carrier in the provision of any network element and thus has no duty to construct or otherwise obtain, whether upon a separate charge or otherwise, a network element for a requesting carrier.

This conclusion is consistent with the clear purpose of unbundling network elements in the Act. Unbundling under Section 251(c)(3) is a means by which a competing carrier can obtain network functions and facilities which such carrier cannot economically provide for itself, but which are technically feasible to be provided by an ILEC. Unbundling is not, however a license to force an ILEC to acquire or construct network elements that it does not possess, or to purchase them in sufficient quantities or capacities

---

[174] 47 U.S.C. Section 153(46).

[175] Southwestern Bell Telephone Co. v. FCC, 19 F.3d 1475, 1480 ("the primary *sine qua non* of common carriage is a quasi-public character, which arises out of the undertaking to carry for all people indifferently"). Under Section 251(c)(3), an ILEC is required to provide network elements (which are not services) as a result of statutory compulsion, but then only to requesting carriers. Thus, there is no voluntary undertaking to provide any service indifferently -- only a requirement to provide network components to a definitionally limited set of potential purchasers.

to supply its competitors. A contrary conclusion would essentially require an ILEC to fund the building of its competitors' networks and would result in an impermissible taking of ILEC property for the private benefit of its competitors.

In deciding whether a network element is available, ILECs are entitled to take into account their own reasonably projected needs, as the Commission concluded was appropriate for determining the availability of space for physical collocation, (and as supported by the United States Department of Justice).[176] It would be unreasonable and anti-competitive to require an ILEC to provide its competitor with any network element that the ILEC reasonably projects it will need itself. Otherwise, the ILEC would essentially be required to build two networks -- one for its own use, and one which could be unbundled for the use of its competitors.

3. SWBT's Proposed Initial Unbundled Network Elements (NPRM - II.B.2.)

SWBT is currently negotiating to provide a number of SWBT unbundled network components which, when utilized with the LSP's interconnection arrangement, will allow the LSP to provide a connection from its switch to its end user's location. These five specific unbundled network elements will readily allow any party to enter the local exchange service market in a flexible, competitively neutral manner. Technologically, they are sufficient for an ILEC's competitor to compete efficiently and on equal terms

---

[176] Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7406-08.

with ILECs. Thus, this level of unbundling is in complete conformity with the spirit and intent of the Act.

Unbundled network elements provide competing carriers the ability to offer exchange services using individual or combined SWBT-provided network elements. Unbundled network elements are intended to be used for the origination and termination of switched traffic. Switched traffic may or may not involve a SWBT switch. The connection from the LSP to SWBT's network may utilize facilities obtained through negotiated interconnection arrangements, including collocation.

SWBT proposes the following unbundled network elements:

Loop: The physical path, distinguished by technical parameters, bandwidth or bit rate, between a network interface on the customer's premises and a point of termination (e.g., MDF, DSX-1) in the SWBT Central Office. Loops are available as 2-wire/4-wire and analog or digital configurations.

Loop Cross Connect: The physical cross-connect from a termination point to a SWBT-provided switched port, a SWBT-provided multiplexer or facility, or a customer-provided multiplexer or facility (2- and 4-wire, analog and digital cross-connects are available).

Switched Port: SWBT central office switch interface hardware providing access to switching functions. Analog and digital (Basis Rate Interface or Primary Rate Interface) switch ports are available.

Local Switching: Provides call processing and switching in a SWBT switch.

Local Switch Transport: Provides for transport of information to and from SWBT's network within a pre-defined local calling scope.

If the Commission decides to establish initial minimum national standards for unbundling, these five proposed network elements would fully meet the goals of the Act, while avoiding complicated technical issues and time-consuming standardization processes.

C. The Act Does Not Restrict Unbundled Rate Levels To Incremental Cost. (NPRM - II.B.2.)

There is no basis for concluding that the Act's definition of cost is restricted to forward-looking incremental costs. Section 251(d)(1) refers to cost without restricting the term in that fashion. In fact, adopting such a restriction would be in conflict with Section 252(d)(1)(B), which permits regulators to allow a reasonable profit.[177] Rate structures that do not recover total costs would conflict with the statutory requirement that rates be "based on the [LEC's] cost" and would not generate profits.[178] Therefore, rates restricted to incremental costs are inconsistent with the Act.

1. Relevant Costs Greatly Exceed Incremental Costs. (NPRM - II.B.2.)

By definition, incremental cost measures only those costs which are directly attributable to production of a particular service. Incremental cost includes, but is not limited to, the capital cost and operating expenses for equipment used to provide a

---

[177] 47 U.S.C. Section 252(d)(1)(B).

[178] "Profit," as used here, refers to the sums reasonably expected, given normal market conditions, which ultimately provide funds for reinvested corporate earnings and dividends to investors.

service, installation costs, switch translation costs, Right to Use fees, and a variety of other service-specific costs such as advertising and product team costs. However, incremental cost ignores the joint costs (those uniquely associated with the provision of a particular group of services), common costs (those incurred to run the firm as a whole), and embedded costs inherent in the operations of multiproduct ILECs. Joint and common costs include, but are not limited to, advertising, marketing, legal, software, switching costs, accounting, operational support systems, and other expenses such as provisioning and engineering. Embedded costs include unit investments in excess of incremental investment and under-depreciated plant.

In addition to joint and common costs, historical investments made in response to an earlier regulatory regime cannot be ignored as if telecommunications history began on February 8, 1996. To take that myopic view would result in an unfair advantage to those who would game the process for self interest rather than the public interest. Specifically, incremental costs fail to account for certain ILEC costs historically incurred to accomplish carrier-of-last-resort and universal service social policy objectives. Certain ILEC investments are made without regard to market conditions or adequacy of consumer demand. To support universal service, for example, ILEC facilities have often been deployed where they were never likely to generate returns sufficient to justify the associated investment as a prudent business decision. Rather, some portion of ILEC capital has been (and continues to be) directed toward ensuring the timely availability of

telephone service to virtually all consumers. These expenditures have made it possible for new entrants, either through the purchase of unbundled elements or resale, to offer a ubiquitous calling capability. Therefore, such ILEC costs should be recouped from new entrants as a part of the cost calculation.

2. Rates Restricted To LRIC Or TSLRIC Would Not Allow For Lawful Recovery Of Costs, Would Hinder Network Advancements, And Would Not Promote Competition. (NPRM - II.B.2.)

The Commission recognizes that various telecommunications firms attempt to distinguish between Long Run Incremental Cost (LRIC) and Total Service Long Run Incremental Cost (TSLRIC). While debates centering around these concepts can easily slip into confusing semantic arguments, both approaches appear to hold in common the use of forward-looking costs, current (or "least cost") technology, and other cost study conventions. To the extent that incremental cost concepts capture only the direct costs of providing a particular service, prices set equal to the incremental cost (however measured, either LRIC or TSLRIC) will fail to contribute toward the recovery of an ILEC's joint, common, and other costs. For that reason, prices set equal to incremental cost are too low. If the prices of every service offered by an ILEC were set at incremental cost, the ILEC's joint, common, and other costs could never be recovered and the ILEC would eventually cease operations and exit the market. Since an ILEC must recover its total operating expenses to remain financially sound, some (or all) ILEC service prices must exceed, perhaps substantially, incremental cost.

Regarding the alternatives discussed in para. 129 of the NPRM, SBC strongly opposes the option that prices "be set based on a narrowly defined LRIC of interconnection service and unbundled network elements, with no allowance for joint or common costs, overheads, or any other added increment." Such LRIC pricing of interconnection is wholly unworkable because it would result in significant, unwarranted deficits for the firms supplying interconnection. Furthermore, it would constitute confiscation under the law. [79]

Prices set equal to incremental costs (either LRIC or TSLRIC), or based on a formula applying a small percentage mark-up above incremental cost, also would likely reduce incentives for infrastructure-enhancing ILEC investment, and could dampen technological innovation. With ILEC rates set at incremental cost, to the extent that market conditions preclude raising other service prices, ILEC revenues and earnings will decline. As a result, the expense and difficulty associated with ILECs securing capital from investors increases. This, in turn, raises the costs of, and probably delays, additional ILEC investments in network enhancements and long-term research projects aimed at product innovation.

---

[179] See Duquesne Light Co. v. Barasch, 488 U.S. 299, 308-310 (1989) ("If the rate does not afford sufficient compensation, the state has taken use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments"); see also FCC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

Encouraging entry by requiring ILECs to provide interconnection and unbundled network elements at prices at, or near, incremental cost would not only penalize incumbents that have traditionally assumed responsibility for carrier-of-last-resort and universal service obligations, but would also deny consumers the benefits of vigorous price competition.[180] Competitively advantageous prices for ILEC interconnection and unbundled network elements (i.e., prices at, or near, LRIC or TSLRIC) would discourage entrants from investing in their own networks and developing new products and services (as opposed to merely offering service packages provisioned by existing ILEC network components). Entrants relying on such artificially low ILEC interconnection and unbundled network element prices would have little, if any, ability to lower industry costs. Therefore, it is unlikely that such entry would produce vigorous retail price competition.

In the NPRM, the Commission makes several references to the MCI/NYNEX Sprint/US West "Benchmark Cost Model" (BCM) as a possible basis for determining cost-based rates for unbundled network elements (e.g., para. 137). As shown in Appendix B, a SWBT empirical study entitled "Analysis and Comparison of Benchmark Cost

---

[180] In The Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, SWBT Comments, April 12, 1996, pp. 14-16, 20-21; SWBT Reply Comments, May 7, 1996, pp. 13-17 and Attachment.